

Letter of Findings: 10-0477
Indiana Adjusted Gross Income Tax
For 2008

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ISSUES

I. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax – Individual Income Tax.

Authority: Ind. Const. art X, § 8; I.R.C. § 61; I.R.C. § 62; IC § 6-3-1-3.5; IC § 6-3-1-3.5 et seq.; IC § 6-3-1-9; IC § 6-8.1-5-1; Peabody v. Eisner, 247 U. S. 347 (1918); Eisner v. Macomber, 252 U.S. 189 (1920); Lucas v. Earl, 281 U.S. 111 (1930); New York v. Graves, 300 U.S. 308 (1937); United States v. Connor, 898 F.2d 942 (3rd Cir. 1990); Wilcox v. Comm'r, 848 F.2d 1007 (9th Cir. 1988); Coleman v. Comm'r, 791 F.2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F.2d 1328 (7th Cir. 1984); Lovell v. U.S., 755 F.2d 517 (7th Cir. 1984); United States v. Romero, 640 F.2d 1014 (9th Cir. 1981); Conner v. United States, 303 F. Supp. 1187 (S.D. Tex. 1969); U.S. v. Buras, 633 F.2d 1356 (9th Cir., 1980); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994); Lacey v. Indiana Dept. of State Revenue, 894 N.E.2d 1113 (Ind. Tax Ct. 2008); [45 IAC 3.1-1-1](#).

Taxpayer argues that the money he received from the business for which he works does not constitute "income" for purposes of determining federal or state income tax.

II. Direct Tax – Individual Income Tax.

Authority: U.S. Const. amend. XVI; I.R.C. § 7701; Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895); Brushaber v. Union Pacific R.R. Co., 240 U.S. 1 (1916); Stanton v. Baltic Mining Co., 240 U.S. 103 (1916); Parker v. Comm'r, 724 F.2d 469 (5th Cir. 1984); Miller v. United States, 868 F.2d 236 (7th Cir. 1989); United States v. Collins, 920 F.2d 619 (10th Cir. 1990).

Taxpayer argues that he is not subject to income tax because Indiana's adjusted gross income tax is an unconstitutional "direct tax."

STATEMENT OF FACTS

Taxpayer filed a 2008 Indiana Income Tax return on which he reported no taxable income. The Department of Revenue rejected the returns, and sent Taxpayer corrected billings. Taxpayer submitted a protest arguing that the returns were correct. An administrative hearing was held during which Taxpayer explained the basis for his protest. This Letter of Findings results.

I. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax – Individual Income Tax.

DISCUSSION

Taxpayer's first argument is that his compensation in exchange for labor does not constitute income, because the wages he receives as compensation for labor do not meet the definition of "income" under the Internal Revenue Code.

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." The Department's decision is therefore presumptively valid.

IC § 6-3-1-3.5 states as follows: "When used in IC § 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code)...." Thereafter, the statute specifies addbacks and deductions, particular to Indiana, which modify the federal adjusted gross income amount. The Department's regulation concisely restates the same formulary principal. [45 IAC 3.1-1-1](#) defines individual adjusted gross income as follows:

Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:

- (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
- (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
- (3) Make all modifications required by IC § 6-3-1-3.5(a).

Both the statute, IC § 6-3-1-3.5, and the accompanying regulation, [45 IAC 3.1-1-1](#), require that an Indiana taxpayer employ the federal adjusted gross income calculation, as determined under I.R.C. § 62, as the starting point for determining the taxpayer's Indiana adjusted gross income.

Under I.R.C. § 62(a), Federal "adjusted gross income" is determined by starting with the taxpayer's "gross income" and subtracting the allowable deductions under the federal tax code. For federal income tax purposes, "gross income" means all income from whatever source and includes compensation for services. I.R.C. § 61. That

portion of I.R.C. § 61 relevant to determining taxpayer's "gross income" states as follows:

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived including (but not limited to) the following items:

- (1) Compensation for services including fees, commissions, fringe benefits, and similar items;
- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowment contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

However, Taxpayer argues that the "pay" he receives from his employer does not constitute taxable wages for either federal or state purposes because he is not "deriving" income from a "source." Taxpayer makes the argument that his labor, in exchange for money, results in no gain or profit to Taxpayer, and, therefore, no income is "derived" from a "source." Taxpayer mainly relies on *Lucas v. Earl*, 281 U.S. 111 (1930). Taxpayer asserts that the decisions of the United States Supreme Court carry more weight to one's position than others, which is certainly accurate. However, the citation from *Lucas v. Earl* which is Taxpayer's basis for his argument is **not** part of the opinion of Justice Holmes, but rather the headnote presumably written by the Reporter of the Supreme Court of the United States (now known as the Reporter of Decisions of the Supreme Court of the United States) summarizing the positions of either party for inclusion in the publication of the opinion in the United States Reports. In fairness, it is understandable how someone who is presumably unfamiliar with reading court cases would make this mistake, but a further reading of the case reveals that the issue before the United States Supreme Court was **not** whether wages were taxable, but rather whether an agreement between a taxpayer and his wife superseded the Revenue Acts of 1918 and 1921, the effect of which would be to limit the amount of income from the taxpayer's salary that was taxable. The Supreme Court actually held that the taxpayer's **entire salary was taxable**, or in other words, **the wages earned from the taxpayer's labor were held to be taxable as income**, thus completely contradicting Taxpayer's contention that *Lucas v. Earl* is in support of Taxpayer's position. Therefore, not only does *Lucas v. Earl* not stand for the proposition that wages and other compensation are not taxable, it actually holds the opposite to be true.

Taxpayer cites to numerous other cases, most of which will not be addressed here. It is sufficient to say that the cases simply do not get Taxpayer where he wants to go, either because they predate the Sixteenth Amendment, are of limited applicability because the issue before the court was not a tax matter, are from another territory of the United States, or are contradicted within the very case to which Taxpayer cites. For example, Taxpayer cites to *Conner v. United States*, 303 F. Supp. 1187 (S.D. Tex. 1969) in which the court held that the plaintiff taxpayers' receipt of fire insurance proceeds did not constitute taxable income. *Id.* at 1191. Nowhere in that case did the court find that individuals were not responsible for reporting their income and paying tax on their wages. Taxpayer's quote from this case is taken completely out of context, as are quotes from many other cases to which Taxpayer cites. For instance, Taxpayer cites to *Eisner v. Macomber*, 252 U.S. 189 (1920), in which the United States Court addressed the issue of whether the U.S. Const. amend. XVI permitted the government to tax a taxpayer's stock dividend resulting from a corporation's accumulated profits. The Court held that the stock dividend did not involve the realization of a taxable gain but that the corporation's accumulated profits were simply capitalized or retained as surplus. *Id.* at 211. In effect, the taxpayer in *Eisner* did not realize a gain severed from and independent of the corporations' assets. *Id.* at 211-12. In reaching that decision, the Court stated that income is the "gain derived from capital, from labor, or from both combined." *Id.* at 201. The Supreme Court did not rule at all on whether wages earned from labor were taxable. However, the Supreme Court went on to discuss what constituted income, stating that:

Just as we deem the legislative intent manifest to tax the stockholder with respect to such accumulations only if and when, and to the extent that, his interest in them comes to fruition as income, that is, in dividends declared, so we can perceive no constitutional obstacle that stands in the way of carrying out this intent when dividends are declared out of a pre-existing surplus.... **Congress was at liberty under the amendment to tax as income, without apportionment, everything that became income, in the ordinary sense of the word, after the adoption of the amendment, including dividends received in the ordinary course by a stockholder from a corporation**, even though they were extraordinary in amount and might appear upon analysis to be a mere realization in possession of an inchoate and contingent interest that the stockholder

had in a surplus of corporate assets previously existing. (**Emphasis added**).

Id. at 204. Here the United States Supreme Court quoted one of their prior decisions, *Peabody v. Eisner*, 247 U.S. 347 (1918). It is language like this that Taxpayer conveniently ignores when choosing the quotes upon which he relies that happen to come from cases that completely discredit Taxpayer's argument.

Essentially, Taxpayer's legal analysis on this issue stands for nothing more than, when read in isolation and selectively divorced from the factual setting under which the decisions were reached, a legal argument can be proposed which will support any legal conclusion no matter how unjustified that conclusion is ultimately found. Despite Taxpayer's best efforts to pick and choose quotations from various court decisions, the United States Supreme Court and various federal and state courts have clearly stated that the income of individual citizens, including wages earned in compensation for labor, may be subjected to an adjusted gross income tax. In *New York v. Graves*, 300 U.S. 308 (1937), Justice Stone stated "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized." Id. at 312-313.

More to the point, the federal courts throughout the land have consistently, repeatedly, and without exception, determined that individual wages are taxable as income. In *U.S. v. Buras* 633 F.2d 1356, 1361 (9th Cir. 1980), the United States Court of Appeals determined that wages can be taxed, despite the taxpayer's argument that a wage earner does not gain anything from that source. Id. at 1361. The court in *United States v. Connor*, 898 F.2d 942, 943-44 (3d Cir. 1990), cert. denied, 497 U.S. 1029 (1990) stated that "[e]very court which has ever considered the issue has unequivocally rejected the argument that wages are not income." *Wilcox v. Comm'r*, 848 F.2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); *Coleman v. Commissioner of Internal Revenue*, 791 F.2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); *United States v. Koliboski*, 732 F.2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable") (Emphasis in original); *United States v. Romero*, 640 F.2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable.... [Taxpayer] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical issue, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United States Supreme Court and federal circuit courts, and this Court's opinion... all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." *Snyder v. Indiana Dept. of State Revenue*, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). See also *Thomas v. Indiana Dept. of State Revenue*, 675 N.E.2d 362 (Ind. Tax Ct. 1997); *Richey v. Indiana Dept. of State Revenue*, 634 N.E.2d 1375 (Ind. Tax Ct. 1994); *Lacey v. Indiana Dept. of State Revenue*, 894 N.E.2d 1113 (Ind. Tax Ct. 2008).

I.R.C. § 3121(a)(1) plainly states that, "For purposes of this chapter the term 'wages' means all remuneration for employment...." The argument about whether wages earned for services is "derived" from a "source" or not is irrelevant because for income tax purposes, "gross income means all income from whatever source derived, including (but not limited to)... (1) **compensation for services**" (**Emphasis added**). I.R.C. § 61(a). Clearly, the IRC provides that wages are income and subject to tax.

As set out in the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art X, § 8. The Indiana General Assembly exercised its constitutional prerogative by imposing an adjusted gross income tax on individuals and corporations. IC § 6-3-1-3.5 et seq. In doing so, the General Assembly defined an individual subject to the adjusted gross income tax as a "natural born person, whether married or unmarried, adult or minor." IC § 6-3-1-9.

"All individuals, natural or unnatural, must pay federal income tax on their wages, regardless of whether they received any 'privileges' from the government." *Lovell v. U.S.*, 755 F.2d 517, 519 (7th Cir. 1984). Taxpayer's argument that the compensation he receives from his labor is not subject to tax, because it is not "derived" from a "source," is completely meritless, as it has been proven to be on numerous other occasions throughout the country. Taxpayer has also brought nearly identical arguments before the Department before, and each one has been proven to be equally meritless.

FINDING

Taxpayer's protest is denied.

II. Direct Tax – Individual Income Tax.

DISCUSSION

Taxpayer submitted additional items for protest in the form of a letter found on another tax protester's website, which is, for the most part, unaltered by Taxpayer. According to a summary of the issues found in Taxpayer's letter, the compensation he receives from his employer is not subject to income tax because:

Section 1 of Subtitle A does not impose a direct tax on the domestic income of individuals who are American citizens; that Section 61 does not identify domestic "sources" that American citizens are subject to report and pay tax on; and that Sections 6001, 6011 and 6012 do not identify citizens as "persons" required to file a Form 1040 return reporting their own income as taxable, and that there is no statute in existence that makes

any person liable for the payment of the Subtitle A income except Section 1461, making the Withholding Agent liable for the tax that he has collected from subject persons. And, that all of this is easily provable today from a simple and uncomplicated reading of the actual provisions of the statutes as herein demonstrated.

It is unclear whether Taxpayer did his own research into the matter to determine for himself if the argument contained in this letter is "easily provable... from a simple and uncomplicated reading of the actual provisions of the statutes."

Taxpayer's letter cites to *Brushaber v. Union Pacific R.R. Co.*, 240 U.S. 1 (1916) and *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1916) for support of the proposition that the United States Supreme Court did not declare that the Sixteenth Amendment authorizes a direct, non-apportioned income tax. Rather, these cases somehow clarified that the United States Supreme Court's decision in *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), in that Congress has certain powers to tax, but that Congress is still limited to the powers of indirect taxation. These cases permit no such conclusion. The fact of the matter is that the Court in *Brushaber* rejected an argument to the contrary and stated as follows:

Nothing could serve to make this clearer than to recall than in the *Pollock Case*, in so far as the law taxed incomes from other classes of property than real estate and invested personal property, that is income from "professions, trades, employments or vocations," its validity was recognized; indeed it was expressly declared that no dispute was made upon that subject, and attention was called to the fact that taxes on such income had been sustained as excise taxes in the past.

Brushaber, 240 U.S. at 17. (Internal citations omitted). Taxpayer's reliance on the *Brushaber* opinion is misplaced. The Court clearly stated that, "[T]he command of the Amendment [is] that all income taxes shall not be subject to apportionment by a consideration of the sources from the taxed income may be derived...." *Id.*, 240 U.S. at 18.

As stated in the U.S. Const. amend. XVI, "The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." The language and effect of this constitutional amendment is plain, and since its proper and legal ratification in 1913, never has the United States Supreme Court declared it to be unconstitutional, or the resulting non-apportioned direct income tax scheme which resulted.

In fact, every court which has considered the issue has either implicitly or explicitly held that the Sixteenth Amendment legally authorizes a non-apportioned direct income tax on United States citizens and that the federal laws as applied are valid. In *United States v. Collins*, 920 F.2d 619, 629 (10th Cir. 1990) the court cited to *Brushaber*, and noted that the United States Supreme Court has recognized that the "sixteenth amendment authorizes a direct nonapportioned tax upon United States Citizens throughout the nation." As the court held in *Parker v. Comm'r.*, 724 F.2d 469, 471 (5th Cir. 1984):

The authority conferred upon Congress by § 8 of article 1 "to lay and collect taxes, duties, imposts and excises" is exhaustive and embraces every conceivable power of taxation has never been questioned, or, if it has, has been so often authoritatively declared as to render it necessary only to state the doctrine. And it has also never been questioned from the foundation... that there was authority given... to lay and collect income taxes. *Brushaber v. Union Pacific Ry. Co.*, 240 U.S. 1, 12-13.

The sixteenth amendment merely eliminates the requirement that the direct income tax be apportioned among the states. The immediate recognition of the validity of the sixteenth amendment continues in an unbroken line.

Arguments to the contrary – such as those posed by Taxpayer – have been uniformly rejected as "patently frivolous." *Miller v. United States*, 868 F.2d 236, 242 (7th Cir. 1989).

With that being said, the remainder of the arguments contained in the letter are without merit, as the constitutional issues upon which they are based on are incorrect, as explained above. Further, I.R.C. § 7701(c) states that, "The terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined." I.R.C. § 7701(c) specifically refutes the attenuated interpretation forwarded by Taxpayer of I.R.C. §§ 6001, 6011 and 6012 that "citizens" are not required to file income tax. Since Taxpayer as a "citizen" is a "person" subject to the federal income tax provisions, the argument regarding the provisions of I.R.C. § 1461 for nonresident aliens are likewise completely irrelevant, as are the other regulations to which Taxpayer has cited insofar as Taxpayer believes that they prove his point. Finally, any arguments about the term "source" have been addressed in Issue I.

FINDING

Taxpayer's protest is denied.

SUMMARY

Each and every portion of Taxpayer's protest is denied in its entirety.

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